UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

THE CITY OF PROVIDENCE, Individually and on Behalf of All Others Similarly Situated,	)	No. 11-CV-7132 (CM)(THK)
Plaintiff,	)	CLASS ACTION
vs.	)	**PLAINTIFF'S OPPOSITION TO DEFENDANTS' MOTION TO DISMISS**
AEROPOSTALE, INC., THOMAS P. JOHNSON and MARC D. MILLER,	)	
Defendants.	)	

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PRELIMINARY STATEMENT

On May 5, 2011, Aeropostale announced disappointing earnings for the first quarter of 2011, ***more than 40% below the guidance*** issued only eight weeks earlier. Investors were not expecting this news, and when the market closed that day, the Company's stock dropped 16.5%. Aeropostale's stock fell another 24% on August 4, 2011, when Defendants disclosed that the Company anticipated second quarter earnings of only $0.02 - $0.03 per share, ***more than 60% below the guidance*** issued only seven weeks earlier. Actual second quarter results were released two weeks later, showing that the Company would have lost money if not for a non-recurring pre-tax benefit. The Company's stock dropped another 14%.

In their motion to dismiss, Defendants explain that Aeropostale's primary customers, teenage girls, are fickle buyers and that Defendants could not possibly have anticipated the magnitude of the sharp drop in sales during the first two quarters of 2011. Ignoring the significant stock drops, Defendants also argue that investors were not surprised by disclosures of rising inventory levels and lower margins because Defendants purportedly disclosed those problems.

As set forth in the Complaint, however, Plaintiff alleges in detail that Defendants did know that their guidance was misleading when made and that Defendants misleadingly downplayed the problems the Company experienced moving unpopular inventory. In December 2010, Aeropostale fired Mindy Meads (the former Co-CEO and Chief Merchandising Officer) whose altered design styles led to poor sales in the 2010 back-to-school and holiday lines. Defendants knew – but failed to disclose – that the spring and summer 2011 lines designed and already ordered by Meads were in the same unpopular style and would also not sell well, thereby adding to the inventory glut. Defendants had access to detailed, daily reports showing inventory on the constant rise and margins on the steady decline during the Class Period (March 11, 2011 through August 18, 2011). The rise in inventory and the decline in margins involved the Company's core line of business, female teen apparel. Former employees of the Company confirmed that sales were on a downward trend throughout the Class Period, with no up-tick at the beginning of the quarters. By issuing guidance after 3-6 weeks of sales were in the books, and with the benefit of sophisticated data systems that monitored the sale of each item at each store on a real time basis, the misses of 40-60% were unprecedented and inexplicable as no "new developments" occurred after guidance was issued to account for these material misses. An industry expert with over 40 years experience reviewed all relevant and available data and concluded that there was no reasonable basis for the forecasts when made.

Defendants muster much of their attack on the absence of "smoking gun" evidence to support Plaintiff's claims and on the absence of a defined motive to commit fraud. These arguments should be disregarded as the law is clear that *to plead scienter,* motive need not be shown and, prior to discovery, "smoking gun" evidence should not be expected. Here, viewed holistically, the Complaint's allegations that Defendants knowingly or recklessly misled investors is as least as compelling as any non-culpable inference.

Defendants also argue that even if the guidance offered was misleading or the statements made about the Company's efforts to bring their inventory levels under control were deceiving, they were all "forward-looking" statements, accompanied by meaningfully cautionary language, thereby protected by the PSLRA's "safe harbor" provisions. Many of the statements describing steps Defendants' had already taken to bring inventory levels under control, or historical data regarding February 2011 sales, however, were clearly not forward-looking. And, much of the so-called "cautionary language" was meaningless boilerplate language, warning that what had already occurred might happen in the future.

STATEMENT OF RELEVANT FACTS[1]

A. The Nature of Aeropostale's Business

Aeropostale is a specialty retailer of casual apparel and accessories, principally targeting 14 to 17 year-old young women, offering clothing lines attractive to its teen-age audience (jeans, graphic t-shirts, and tops featuring the Company's Aeropostale label). ¶32-33.[2] The Company generates approximately 70% of its revenue from its young women's line. ¶¶38-42.

B. Aeropostale's Deviation From Its Traditional Clothing Line in 2010-2011

Aeropostale posted record profits during the first half of 2010, offering a line of clothing and accessories that was consistent with what its customers had come to expect. ¶6. This success, however, did not continue into the typically strong second half of 2010. ¶7. Under the direction of Mindy Meads, the Company took the Aeropostale brand in a different direction, adopting new styles in its young women's line consisting of a muted color palate with more mature designs. ¶56-59. This clothing was a marked departure from the more "wholesome" styles and bright colors that the Company had typically sold. *Id.* Johnson supervised Meads and the Company's merchandising and design department. ¶35.

This change was received very poorly by Aeropostale's core female customers. Inventory of unsold clothing began piling up during the 3Q10 and became more pronounced in the 4Q. ¶¶62-63. The departure from the Company's "core offering" was such a disaster that the Company fired Meads in early December 2010. ¶58. Unfortunately, firing Meads did not fix the problem. The Company had already over-ordered its young women's clothing lines for the winter, ***as well as spring and summer of 2011***, using Meads' misguided style designs. ¶36.

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[1] The statement of relevant facts is taken from the Complaint and based on the Company's SEC filings, earnings conference call transcripts, other publicly available information, and interviews of numerous former employees of Aeropostale (each referred to herein as "confidential witness" or "CW"). These CWs are described more fully herein in Section II. C.

[2] All references to "¶__" are to paragraphs of the Amended Complaint ("Complaint") (Docket No. 21).

C. Aeropostale's Information Management Systems Implemented in 2010 Allowed Defendants to Monitor Inventory Levels, Sales, Pricing and Margins in Real Time

By the end of 2010, the Company had in place sophisticated management information systems, including a new "data warehouse" system which allowed Defendants to monitor, on a daily basis, inventory levels, sales data, pricing, and margins. ¶¶10, 43-45, 122-123. Every night, "polling" from each Aeropostale cash register allowed for the creation of daily "flash reports" reflecting, on a Company-wide basis, units sold, revenue generated, margins, remaining inventory, and other data, including a ***daily*** review that compared margins and sales year over year. ¶¶47-51. Defendants had access to and utilized these flash reports. ¶49. An abbreviated version of the flash report, the "Bible," was distributed daily to Defendants and provided them with a "snapshot" of the information available in greater detail in the flash reports. ¶51.

Aeropostale's management met frequently to discuss the data reflected in the flash reports and in other periodic reports. ¶¶46, 52-55. Unit-Q reports contained comparative metrics, showing trends in weekly sales figures, average unit retail, and ***projections*** for future sales. ¶53. Starting in late 2010, the Unit-Q reports showed a consistently downward weekly trend for every product type. ¶53. Defendants attended weekly Executive Committee meetings and monthly "Unit Q" meetings where the downward trends and projections were discussed. ¶¶46, 52-55.

D. Aeropostale's History of Accurate Financial Guidance

With the assistance of the databases described above, starting in the second half of 2010 Defendants were able to track and analyze Aeropostale's inventory and sales metrics with precision. ¶¶43-45. This, in turn, allowed Defendants to systematically provide accurate financial guidance to investors. ¶¶11, 96. The financial guidance Defendants offered was not meaningless guesswork and did not hinge on the "fickle" nature of the Company's core customers. Indeed, Defendants provided accurate guidance for 3Q10 and 4Q10 despite lowered sales attributable to Meads' misguided style changes. By the time Defendants provided investors with guidance, ***three to six weeks into a quarter***, they already had a keen understanding of which lines were moving, which lines required additional promotion, the extent of the promotion required, and which lines would simply not sell at all. ¶¶45, 122-123.

The detailed, real time financial and inventory data allowed Defendants to issue guidance that they could consistently meet or beat. ¶¶16, 96. The market came to expect these predictable results. *Id.* Absent a material change in circumstances after providing investors with guidance, there was simply no legitimate reason for Defendants to *significantly* fall short of the guidance they offered to investors. ¶¶12, 133-134.

E. While the Inventory Crisis Worsened and Margins Plummeted, Defendants Reassured Investors with False Statements Regarding Status of Inventory and by Providing Knowingly False Financial Guidance

Adoption of new styles for the back-to-school and holiday seasons in 2010 was not well received by Aeropostale's core female customers. ¶¶56-59, 63. This in turn led to weak sales and a huge inventory glut. ¶¶8, 56-57. December sales, for example, were off 20-30%, resulting in a significant build up of holiday inventory that would carryover into 2011. ¶63.

Predictably, the inventory back-up worsened in 2011, as the Company's new styles, ordered months earlier, continued to be rejected by Aeropostale's customers. ¶¶66-78. Unsold clothing was first moved to the back of stores and then off-site. ¶67. In February 2011, sales continued to decline and inventory continued to increase. ¶68. In fact, these trends continued throughout the first quarter. *Id.* Things were so bad that the Company tested a never before used "buy one, get *two* free" sale. ¶70. Other unprecedented promotions were also tried. ¶72. Of course, moving inventory with promotions like these came at a heavy price, drastically impacting the Company's profitability. ¶¶70, 73.

Most importantly, with the capabilities provided by the Company's sophisticated inventory management and financial databases, Defendants knew with great precision that earnings in the first and second quarters of 2011 would not come close to the relatively strong earnings reported during the first two quarters of 2010 or to the publicly forecasted earnings for the first two quarters of 2011. ¶¶18, 81-82, 102-103, 108, 133-135.

Defendants did not *completely* hide the challenges they were facing, saying that the Company's financial performance was "below our expectations" while conceding that inventory levels were growing. ¶¶79, 88. But each time Defendants "spoke" to investors during the Class Period, they significantly and materially downplayed the extent of the inventory problems they knew the Company was facing, and they provided bullish financial guidance that they knew could not be achieved. ¶¶94-95, 110. Defendants also failed to disclose known facts that would have alerted investors to the truth, *i.e.*, that the Company had already ordered Meads' now rejected styles for the spring and summer 2011 lines and that the inventory glut would continue to worsen throughout the first half of the year. ¶18.

On March 10, 2011, the beginning of the Class Period, Aeropostale provided financial guidance for 1Q11. ¶¶79, 83. While conceding that the Company performed poorly during the second half of 2010 and that promotional efforts were ongoing, Defendants nevertheless elected to provide bullish earnings guidance ($0.35-$0.38 per share), only slightly below the Company's record earnings achieved during the first quarter 2010. ¶¶13, 79. Defendants also stated that the Company expected to "clear[ ] though" its 2010 holiday inventory during the first quarter (¶¶79, 86-88), advising that they had already "taken the necessary steps" to fix the problems with their merchandise (¶86)--despite knowing that orders for the spring and summer 2011 lines featuring Meads' failed designs had already been placed. ¶18.

On May 5, 2011, the Company announced preliminary results for the first quarter. ¶97. Earnings per share were only $0.20, compared to the $0.35-$0.38 projected only eight weeks earlier—***more than a 40% miss***. *Id.* Defendants claimed that they were lulled into the sense that the quarter would be strong based on a relatively strong February, claims refuted by Company employees. ¶¶14, 68, 105.

On May 19, 2011, Aeropostale provided guidance for the second quarter. ¶¶101, 105. Defendants told analysts, with the quarter well underway, that they anticipated earnings per share of $0.11-$0.16. *Id.* There was simply no reasonable basis for guidance of this magnitude given the unprecedented promotional efforts that Defendants knew were already in place and the continued problems selling Meads' designs. ¶¶102, 104, 134. Analysts once again were led to believe that the inventory problems were now manageable. ¶110.

On August 4, 2011, Defendants announced shockingly low preliminary 2Q11 earnings per share of only $0.02-$0.03, ***a miss of more than 60%***. ¶111. In response, Aeropostale's stock dropped 24%. ¶114. On August 18, 2011, nearly ***five months*** after they assured the market they ***had taken the necessary steps*** to fix their fashion mistakes, Defendants finally conceded the depth of the problem and the ongoing need to offer unprecedented promotions to move spring and summer inventory. ¶¶117, 119. Defendants belatedly acknowledged that the styles offered for the ***spring and summer 2011 seasons*** had consisted of the muted, mature styles that Meads had previously ordered. ¶121. Aeropostale's stock dropped another 14%. ¶126.

ARGUMENT

I. LEGAL STANDARD

On a motion to dismiss under Rule 12(b)(6), "the Court must liberally construe all claims, accept all factual allegations in the complaint as true, and draw all reasonable inferences in favor of the plaintiff." *Camofi Master LDC v. Riptide Worldwide, Inc.*, No. 10-4020, 2011 WL

1197659, at *5 (S.D.N.Y. Mar. 25, 2011) (McMahon, J.). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.' A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 566, 570 (2007)). "The test is not whether the plaintiff ultimately is likely to prevail, but whether he is entitled to offer evidence to support his claims." *In re Veeco Instruments, Inc. Sec. Litig.*, 235 F.R.D. 220, 226 (S.D.N.Y. 2006) (McMahon, J.).

II. THE COMPLAINT'S ALLEGATIONS, VIEWED AS A WHOLE, RAISE A STRONG INFERENCE OF DEFENDANTS' SCIENTER

A. Standards for Alleging Scienter

Tellabs Inc. v. Makor Issues & Rights, Ltd. 551 U.S. 308 (2007) sets forth two key principles for evaluating scienter. First, "the [appropriate] inquiry ... is whether all of the facts alleged, ***taken collectively***, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 310 (emphasis in original). Second, "[t]he inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the 'smoking gun' genre, or even the 'most plausible of competing inferences.'" *Id.,* at 324 (citation omitted). "[I]f the plaintiff demonstrates only that an inference of scienter is at least as compelling as any nonculpable explanation for the defendant's conduct, the tie goes to the plaintiff." *City of Brockton Ret. Sys. v. Shaw Group Inc.*, 540 F. Supp. 2d 464, 472 (S.D.N.Y. 2008) (McMahon, J.).

In this Circuit, a strong inference of scienter can be established by alleging **either** (1) motive and opportunity **or** (2) conscious misbehavior or recklessness. *ATSI Commc'ns. Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007); *In re Bristol Myers Squibb Co. Sec. Litig.*, 586

F. Supp. 2d 148, 167 (S.D.N.Y. 2008). The archetypical proof of scienter is a showing that defendants "knew facts or had access to information suggesting that their public statements were not accurate . . . or [] failed to check information they had a duty to monitor." *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

B. Defendants' Review of Periodic Reports Supports a Strong Inference of Scienter and Allowed for Provision of Accurate Guidance

As detailed in the Complaint, Defendants had access to and were, in fact, routinely provided information in the form of flash reports, the Bible, the Unit-Q and Merchandising reports that contradicted their public statements concerning Aeropostale's inventory, earnings, profitability and outlook. ¶¶47-54. Scienter is sufficiently alleged where, as here, Defendants have access to and review reports that contradict their public statements. *See e.g., New Orleans Emps. Ret. Sys. v. Celestica, Inc.*, No. 10-4702-CV, 2011 WL 6823204, at *2 (2d Cir. Dec. 29, 2011) (plaintiffs "provided sufficient facts as to who prepared the spreadsheets, how frequently they were prepared, who reviewed them, and the issues they addressed"); *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 76 (2d Cir. 2001) (sales data and reports demonstrated "what defendants knew on a daily, weekly and monthly basis about the retail trade of [Scholastic] books, while at the same time making public statements that painted a different picture."); *Novak*, 216 F.3d at 313.[3] These reports allowed Defendants to provide accurate guidance.

Three to six weeks into a quarter, it was Defendants' practice to utilize the information

[3] Numerous other courts are in accord. *See, i.e., In re Imax Sec. Litig.*, 587 F. Supp. 2d 471, 481 (S.D.N.Y. 2008) (scienter shown where defendants participated in meetings and received weekly reports discussing facts contrary to public statements); *Freudenberg v. E*Trade Fin. Corp.,*712 F. Supp. 2d 171, 198 (S.D.N.Y. 2010) ("meetings, where the problems at issue were directly discussed with Defendants, evidence scienter"); *In re Priceline.com Sec. Litig.*, 342 F. Supp. 2d 33, 49 (D. Conn. 2004) (defendants "had access to a steady flow of information from intra-corporate reports" indicating, contrary to public disclosures, that the company would continue to sustain substantial financial losses).

contained in the various periodic reports to provide investors with guidance for the balance of the quarter. ¶¶11, 12. In 2010, for example, Defendants provided accurate guidance during the traditionally strong second half of the year. The adverse impact of Meads' back-to-school and holiday style change did not thwart Defendants' ability to provide accurate guidance. ¶¶11-13.

Defendants argue that Plaintiff "cherry pick[ed]" the quarters to support Plaintiff's argument. Comparing 2009 guidance and actual results, a period of time when actual results ***beat*** guidance, Defendants contend that the accuracy of their guidance was not so exact. (Def. Br. at 2-3, 16-17). In fact, once the warehouse data system was implemented in 2010, Defendants only ***missed*** guidance in the two quarters during the Class Period. Nothing occurred in either quarter after Defendants issued guidance that should have altered the numbers that Defendants had already been tracking on a real time basis. ¶¶12-17. Even after the Class Period, Defendants ***met or beat*** guidance in every quarter. Def. Br. at 17. Moreover, a determination of whether the 2009 results support or contradict Plaintiff's point that prior to the first two quarters of 2011, Defendants' reliance on internal financial reports allowed them to provide accurate guidance would require the court to make a factual determination, inappropriate when ruling on a motion to dismiss. *In re Bear Stearns Cos, Inc., Sec., Derivative, and ERISA Litig.,* 763 F. Supp. 2d 423, 496 (S.D.N.Y. 2011).

C. Confidential Sources Support a Strong Inference of Scienter

Plaintiff's scienter allegations are supported by the accounts of nine former Aeropostale employees, several of whom held senior management positions, had personal interactions with Johnson and Miller, and provided (or had personal knowledge that these Defendants were provided) specific reports and information that rendered their public statements false and misleading. Moreover, many of these CWs corroborate one another--providing further cogent support for a strong inference of scienter. *See In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir.

2002) ("The consistent [witness] accounts reinforce one another and undermine any argument that the complaint relies unduly on the stories of just one or two former employees.").

Tellingly, Defendants wholly ignore seven of Plaintiff's nine confidential witnesses. The accounts of all the CWs, reviewed together, and with the Complaint's other scienter allegations paint a compelling picture of a Company in the self-created throes of an inventory crisis that Defendants knew would get worse and prevent the Company from meeting its guidance or clearing through its excess inventory in the first half of 2011. For example:

- CW1, CW2, CW5 and CW7 together confirm that the Company's fashion changed direction during the second half of 2010, instituting the more mature, muted color palate that Meads conceived. Defendants knew about this change, were complicit in this change, and acknowledged their mistake by firing Meads in December 2010. ¶¶56-59.

- CW2 and CW3 together confirm that the Women's Department had over ordered the unpopular Meads' styles through summer 2011—the end of 2Q2011. ¶¶60-61.

- CW1, CW2, CW3, CW4, CW6 and CW9 together confirm that that the inventory crisis began in the second half of 2010 and intensified in early 2011 and throughout the Class Period. ¶¶62-63, 66-78.

- CW1, CW2, CW4, CW5, CW6 and CW8 together confirm that Defendants had access to, reviewed, and discussed the flash reports, the Unit Q reports, the Bible and sales reports, which contained detailed information on a "real time basis" of information that showed the Company would not be able to meet the bullish guidance provided by Defendants during the Class Period or rectify the excess inventory problem in the first half of 2011. ¶¶47-55, 78, 99, 104.

- CW1 was present at Executive Committee meetings where the inventory crisis was discussed and where Defendants acknowledged that the heavily discounted merchandise still was not selling. ¶46. CW1, CW2 and CW9 confirm that the Executive Committee met every Monday at the Company's headquarters in New York. *Id.*

- CW1 and CW2, CW3, and CW9 together confirm that the Company's employed desperate and unprecedented discounts and promotions, which severely affected the Company's margins throughout the Class Period. ¶¶69-73.

- CW2 and CW4 confirm that sales were down in February 2011. ¶68.

Acknowledging that this Court has previously rejected the argument (*see Brockton*, 540 F. Supp. 2d at 474 ("I disagree with the Seventh Circuit's suggestion, contained in *Higginbotham*

… that information in securities fraud pleadings from confidential witnesses should always be discounted.")). Defendants nonetheless urge the Court to adopt *Higginbotham* and completely ignore the CWs' accounts.[4] Contrary to Defendants wishes, the law in this Circuit remains that a plaintiff may rely on CWs to support an inference of scienter where the CWs are "described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged."[5] *See Novak*, 216 F.3d at 314. Recent district court decision are in accord. *See Bear Stearns,* 763 F. Supp. 2d at 504 n.13 ("*Novak* is still the law in the Second Circuit and … this Court has previously rejected *Higginbotham* on this point"); *Glaser v. The9, Ltd.*, 772 F. Supp. 2d 573, 590 n.12 (S.D.N.Y. 2011) (the Second Circuit has "explicitly allowed" the use of CW allegations to support an inferences of scienter).[6] Plaintiff here has met the *Novak* standard for each of the CWs cited and Defendants do not argue otherwise (¶¶30, 46-78).

Defendants' other arguments regarding the CWs essentially boil down to a demand that Plaintiff plead a "smoking gun," *i.e.*, that the CW be a senior executive who was expressly told by a Defendant that he knew the projections would not be met. This level of detail is not and cannot be required at this stage of the case. As courts in this Circuit have long held, the PSLRA does "not require the pleading of detailed evidentiary matter" to establish scienter. *Scholastic*, 252 F.3d at 72; *accord Bear Stearns*, 763 F. Supp. 2d at 485. As described above and in the Complaint, Plaintiff's CW allegations support an inference of scienter.

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[4] Moreover, *Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753 (7th Cir. 2007), was largely discredited by *Makor Issues & Rights Holding v. Tellabs, Inc.*, 513 F.3d 702, 712 (7th Cir. 2008) (clarifying that the weight awarded anonymous sources largely depends on the details provided about these sources).

[5] Defendants concede (by not arguing otherwise) that the CWs positions and dates of employment are properly identified in the Complaint and that the CWs were in position to know what the Complaint attributes to them. Any attempt to argue these issues for the first time on reply should be rejected. *See In re Adelphia Commc'ns Corp. Sec. & Derivative Litig.*, 398 F. Supp. 2d 244, 250 n.6 (S.D.N.Y. 2005) ("Reply papers are not the proper place for new arguments.").

[6] Defendants' reliance on *dicta* from *Campo v. Sears Holdings Corp*, 371 F. App'x. 212, 216 n.4 (2d Cir. 2010) is misplaced. *Campo* did not overrule *Novak*. Indeed, the *Campo* Court fully considered the CWs accounts offered by the plaintiffs in that case.

D. Industry Expert Supports a Strong Inference of Scienter

Plaintiff's industry expert, Allan Zwerner, has over 40 years of experience working in the retail and wholesale industry and has served as a high level executive at major clothing companies. ¶127. In Mr. Zwerner's opinion, there was no reasonable basis to issue the guidance given during the Class Period. ¶¶133-34.

Defendants argue generally that expert opinions like those offered here cannot support the showing of a strong inference of scienter. Defendants are wrong. Courts routinely accept an expert's opinion as part of the scienter mosaic. *See Arlund v. Deloitte & Touche LLP*, 199 F. Supp. 2d 461, 483 (E.D. Va. 2002) (relying in part on the experts cited in the complaint to find a strong inference of scienter); *Nursing Home Pension Fund, Local 144 v. Oracle*, 380 F.3d 1226, 1233-34 (9th Cir. 2004); *In re Wash. Mut., Inc., Sec. Litig.*, 694 F. Supp. 2d 1192, 1210-12 (W.D. Wash. 2009). None of the cases cited by Defendants consider whether an expert's opinion is probative of scienter on a motion to dismiss. *See* Def. Br. at 19-21 (citing *United States v. Bilzerian*, 926 F.2d 1285 (2d Cir. 1991) (appeal following trial on the merits); *Highland Capital Mgmt. v. Schneider*, 379 F. Supp. 2d 461 (S.D.N.Y. 2005) (decision on motion in limine); *Pension Comm. of the Univ. of Montreal Pension Plan v. Banc of Am. Sec.*, LLC, 691 F. Supp. 2d 448 (S.D.N.Y. 2010) (decision on motion in limine); *In re Rezulin Prods. Liab. Litig.*, 309 F. Supp. 2d 531 (S.D.N.Y. 2004) (decision on motion in limine)). Finally, Defendants' argument that Mr. Zwerner's opinion is based on un-pled "confidential witness reports" is wrong. Def. Br. at 20. Mr. Zwerner's opinion is based on the CW accounts pled in the Complaint as well as publicly available information, SEC filings, and his many years of experience.

E. Core Operations Support a Strong Inference of Scienter

Aeropostale's primary line of business is its clothing line for young women. This was the "core" of the Company's business. ¶¶38-42. Courts routinely hold that where, as here, the alleged fraud involves the Company's core operations, this supports a strong inference of scienter. *See, e.g., Veeco*, 235 F.R.D. at 233 ("[w]here [ ] accounting irregularities relate to accounting practices that are sufficiently critical to the core operations of the company, knowledge of the accounting improprieties may be imputed to the company's officers and directors who are involved in the day-to-day operations of the company."). *See also New Orleans,* 2011 WL 6823204, at *2 n.3; *In re Reserve Fund Sec. & Derivative Litig.,* 732 F. Supp. 2d 310, 318-19 (S.D.N.Y. 2010). Accordingly, considered together with the rest of Plaintiffs' allegations, Defendants' intimate involvement in the core operations of the Company supports a strong inference that they knew that the inventory situation was far worse than presented to investors and that the earnings guidance they provided would not be met.

F. The Magnitude of the Earnings Miss Supports an Inference of Scienter

"[T]he magnitude of the alleged fraud provides some additional circumstantial evidence of scienter." *Bear Stearns*, 763 F. Supp. 2d at 517 (quotations omitted); *Freudenberg*, 712 F. Supp. 2d at 199 n.9. Defendants missed guidance by over 40% in the first quarter and by over 60% in the second. ¶¶13, 16, 101, 116. The magnitude of these earnings misses, considered with the other bases Plaintiff cites in support of its scienter allegations, (*see* § II *supra*), provide a compelling inference that Defendants acted with the requisite scienter.

In *Cement Masons & Plasterers Joint Pension Trust v. Equinix Inc.*, No. 11-01016, 2012 WL 685344 (N.D. Cal. Mar. 2, 2012), cited by Defendants, the size of the revenue projections miss was *de minimus*—2.2% for the quarter and only 1.2% for the year—clearly distinguishing it from Aeropostale where the misses were over 40% in 1Q11 and over 60% in 2Q11.

G. Plaintiff Does Not Need to Allege Motive to Satisfy the Pleading Standard

Defendants focus throughout their motion on the issue of motive, contending that the absence of stock sales by Defendants is fatal to Plaintiff's Complaint. Def. Br. at 2-3, 15-16. However, the Supreme Court has clearly decided that "[t]he absence of a motive allegation … is not fatal." *See Tellabs*, 551 U.S. at 325. Under the PSLRA, "litigants and courts need not and should not employ or rely on magic words such as 'motive and opportunity'" with respect to intent. *Novak*, 216 F.3d at 311.

III. PLAINTIFF HAS ADEQUATELY ALLEGED MATERIALLY FALSE AND MISLEADING STATEMENTS AND OMISSIONS

A. The Non-Forward-Looking Statements Are Actionable

The Complaint identifies a number of misleading statements and omissions that are, contrary to Defendants' arguments, not "forward-looking" and not shielded from liability under the "safe harbor." The statements identified in Section C of Defendants' brief are matters of present or historical facts designed to obfuscate the depth of the Company's inventory dilemma.

1. The Statements Identified as Non-Forward-Looking Were Properly Identified, Misleading and Non-Forward-Looking

The safe harbor "applies only to forward-looking statements," not factual representations. *In re Ambac Fin. Group, Inc. Sec. Litig.*, 693 F. Supp. 2d 241, 272 n.36 (S.D.N.Y. 2010). "[S]tatements about present or historical facts, whose accuracy can be determined at the time they were made, are not forward-looking statements falling within the PSLRA's safe harbor." *In re Vivendi Universal, S.A. Sec. Litig.*, 765 F. Supp. 2d 512, 569 (S.D.N.Y. 2011). Plaintiff properly identifies the following statements as non-forward-looking and misleading (¶162(a-f)):

a. Johnson and Miller's March 10, 2011 statement that the Company's "outlook for the first quarter reflects the impact from clearing through holiday inventories …" ¶¶79, 84.

Although Defendants used the word "outlook," the point of this statement is that the Company-provided guidance is premised on the Company ridding itself of stale holiday inventory in the present, which was simply not the case. ¶82. "[T]he safe harbor does not protect statements which are misleading about historical and present facts at the time they are made, and whose misleading nature can be verified at the time they are made, ***simply because the statements are couched as predictions of future events***." *Vivendi*, 765 F. Supp. 2d at 569 (emphasis added). Moreover, "it is well recognized that even when an allegedly false statement 'has both a forward looking aspect and an aspect that encompasses a representation of present fact,' the safe harbor provision of the PSLRA does not apply." *In re Nortel Networks Corp. Sec. Litig*., 238 F. Supp. 2d 613, 629 (S.D.N.Y. 2003) (quoting *In re APAC Teleservice*, *Inc. Sec. Litig*., No. 97-civ-9145, 1999 WL 1052004, at *7 (S.D.N.Y. Nov. 19, 1999).[7]

b. Johnson's March 10, 2011 statement that the Company had "taken the necessary steps to give customers what they want" and Miller's statement that the Company was "appropriately attacking the inventory problem".

Both of these statements, ¶¶86, 88, issued mid-way through 1Q2011, were intended to and did in fact convey the message that (1) Aeropostale had already fixed the problems with the unpopular Meads' styles from the back half of 2010 by ordering different styles for spring and summer 2011, and (2) that inventory was under control and being reduced. There is nothing forward-looking or true about the messages Defendants conveyed. ¶¶87, 91.

c. Johnson's May 19, 2011 statement: "I think that the positive outlook that we have is grounded in the fact that we know that the mistakes that we made and that we have taken steps to rectify those and to get this brand back on course."

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[7] At the very least, such "mixed" present and future statements are severable. *See Iowa Pub. Emps.' Ret. Sys. v. MF Global Ltd.*, 620 F.3d 137, 144 (2d Cir. 2010) ("A statement may contain some elements that look forward and others that do not.... But in each instance the forward-looking elements and the non-forward-looking are severable.").

Johnson's statements, ¶107, conveyed the impression that the previously announced promotional campaigns would be sufficient to rectify the inventory overhang and that this gave reason to be optimistic about the Company's fortunes in 2Q11. ¶108. There is nothing forward-looking about this statement; it was even worded in the past tense. And it was untrue. Johnson knew that the spring and summer lines were as unpopular as the fall and winter lines, and that there was no basis to say that the Company had taken the necessary steps that would allow the brand to get "back on course" in May 2011. *Id.*

d. Johnson's March 10, 2011 statements that Defendants "feel very good about the product going forward" and are "excited about some of the fashion components we are delivering for spring." ¶90.

These statements of present fact regarding the Company's spring line, which had already been ordered in the same failed styles as the merchandise from the prior two seasons, are not forward-looking and are actionable. Merely using words such "feel" or "think" or "believe," for instance, does not "change the assertive nature" of otherwise non-opinion, non-forward-looking statements. *See In re Oxford Health Plans, Inc. Sec. Litig.,* 187 F.R.D. 133, 141 (S.D.N.Y. 1999).

Collectively, these non-forward-looking statements are distinguishable from those statements that the court found "too vague to be actionable" in *Institutional Investors Group v. Avaya, Inc*., 564 F.3d 242, 255 (3d Cir. 2009). There, challenged statements, *i.e.*, that the company's results positioned it to meet its future "goals," and that it was "on track" to meet its goals were insufficiently vague and were "necessarily implicit in every future projection." *Id.* To the contrary, here, Defendants made statements specific to the Company's sales, inventory, and customer demand at the time, and knew these statements to be untrue when made. *See Novak*, 216 F.3d at 315.

Furthermore, even if any of these statements can be deemed opinions, "[a]n opinion may

... be actionable ... if it is without a basis in fact ... [or if] the speakers were aware of any facts undermining the accuracy of these statements." *Oxford*, 187 F.R.D. at 141. Each of the challenged statements here is actionable under this criteria. For instance, when Miller stated on March 10, 2011 that "we feel like we are appropriately attacking the inventory problem" and "our goal, as always is to end the quarter as cleanly as possible from an inventory standpoint" (¶88), he was acutely aware that the inventory problem was not under control and would not be resolved by the end of 1Q11. Indeed Miller knew at this time that the inventory problem would only grow worse as the Company's spring and summer lines containing the unpopular design styles arrived in stores. ¶87. And when Johnson stated on May 19, 2011 that Defendants had "taken steps to rectify" the mistakes and get the "brand back on course," he knew that the announced promotional campaign could not sufficiently rectify the inventory overhang problem, but rather the unpopular spring and summer 2011 product lines, as well as the stale inventory, were not selling even at steep discounts and promotions would have to be increase substantially.[8]

Finally, Defendants claim that Johnson's statement during the May 19, 2011 earnings call commenting on the Company's "disappointing" first quarter performance can not be fraudulent because it is too "generalized." Def. Br. at 24. They are wrong. First, Johnson's statement that while "February started off well, we experienced a significant deceleration on the business as we moved through March and April," is a matter of historical fact, and therefore not subject to safe harbor protection. Moreover, it is clearly distinguishable from the "generalized, optimistic statements" of future business performance of the ilk at issue in *Frazier v. VitalWorks, Inc.*, 341 F. Supp. 2d 142, 153 (D. Conn. 2004), since it addresses specifically the Company's financial

[8] Defendants also claim that certain of these statements are non-actionable expressions of puffery or corporate optimism. Def. Br. at 23. However, the same reasons that make these statements not forward-looking, namely that they are based on existing facts, disqualify them as "puffery." *See Novak*, 216 F.3d at 315.

performance in the prior quarter. In any event, such statements do "become [ ] fraud if 'defendants had access to contrary facts' and plaintiffs can specifically identify 'reports or statements' containing contrary information." *Id.* at 154 (citing *Novak*, 216 F.3d at 309).

While Defendants point to a 5% reduction in inventory surplus over approximately the first six weeks of the quarter compared with 2010, the Complaint is replete with allegations that Defendants knew that February did not "start off well." *See also* Statement of Relevant Facts Section E, *supra*. Indeed, Plaintiff's CWs have stated that February's sales were just as low as March and April (¶106), a fact that Defendants would have known at the time, as they were admittedly receiving "real time" information on sales and inventory through daily reports and regular meetings. ¶46-55.[9]

2. The Non-Forward-Looking Statements Were Made with Scienter

Defendants urge the Court to adopt an "actual knowledge" standard for scienter for all statements in this case. Def. Br. at 18. For the non-forward-looking statements, however, the standard is mere recklessness. *ATSI*, 493 F.3d at 99. While Plaintiff submits that it has adequately alleged that Defendants had actual knowledge that their guidance was misleading and that their statements concerning the condition of inventory were knowingly false, at the very least, Plaintiff has alleged that Defendants were reckless.

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[9] Even if the Court were to decide that any of the above statements were forward-looking, they are still actionable because Defendants did not adequately identify them as such during the conference calls. The PSLRA's special provisions for oral forward-looking statements require an accompanying statement "that ***the particular oral statement*** is a forward-looking statement." 15 U.S.C. § 78u-5(c)(2)(A)(i) (emphasis added). Defendants rely only on a generic recital at the beginning of the conference call that "certain statements and responses to questions may contain forward-looking information such as forecasts of financial performance." *See* Def. Br. at 11 & Exs. 12 and 18 thereto at 2. This does not qualify as proper identification for oral statements, and, furthermore, the cautionary language is inadequate. *See* Section III.

B. The Forward-Looking Statements Are Actionable and Are Not Protected by the PSLRA Safe Harbor Provisions

Defendants contend that their false forward-looking statements are entitled to safe harbor protection because they were identified as forward-looking and accompanied by meaningful cautionary language. Defendants are wrong.

1. Absence of Meaningful Cautionary Language in Light of Known and Specific Risks

Forward-looking statements must be identified as such and to be accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statements." 15 U.S.C. § 78u–5(c)(1)(A). As the Second Circuit recently explained, a defendant has the burden to demonstrate that the "cautionary language was ***not boilerplate*** and conveyed ***substantive*** information." *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010) (emphasis added). This Court has also stated, "[t]o be meaningful, cautionary language 'must precisely address the substance of the specific statement or omission that is challenged.'" *In re EVCI Colleges Holding Corp. Sec. Litig.*, 469 F. Supp. 2d 88, 102 (S.D.N.Y. 2006) (quoting *Nortel*, 238 F. Supp. 2d at 628).

Here, the allegedly false, forward-looking statements, including the Company's Class Period guidance, were not accompanied by meaningful cautionary language. For instance, Aeropostale's March 10, May 5, and May 9, 2011 press releases stated that "actual results ***might*** differ materially from those projected in the forward-looking statements" due to the occurrence of various "factors that ***could*** cause actual results to materially differ." *See* Def. Br. at 11. And, the Company stated during its March 10, 2011 and May 19, 2011 earnings calls that its "forward-looking information and statements involve known and unknown risks which ***may cause*** our actual results to differ materially form our forecast result." *Id.* This generalized cautionary language is insufficient because it is not "sufficiently specific with respect to the risks which eventuated," and which ultimately caused the Company's earnings to materially differ from those projected. *See Schottenfeld Qualified Assoc. L.P. v. Workstream, Inc.*, No. 05 CV 7092 (CLB), 2006 WL 4472318 (S.D.N.Y. May 4, 2006).

Similarly, the risk factors that Defendants set forth on page 12 of their brief also fail to bring the projections and other forward-looking statements within the protection of the safe harbor. The 10-K disclosures merely elaborate on the general risk factors in the press releases without adding anything of substance. Defendants' risk disclosures boil down to warnings about "fashion trends" or "inventory management" that ***may*** cause the stock price to decrease. These warnings are worthless without stating that the new women's fashion line that was designed by Meads and implemented for the 2010 back-to-school and holiday seasons, and was carried through the ordering of the 2011 spring and summer lines, was not selling, even at steep discounts, and that this was having and would continue to have a significant negative impact on the Company's earnings. Indeed, even "warnings of specific risks ... do not shelter defendants from liability if they fail to disclose hard facts critical to appreciating the magnitude of the risks described." *Bear Stearns*, 763 F. Supp. 2d at 495 (quoting *In re Am. Int'l Group, Inc. 2008 Sec. Litig.*, 741 F. Supp. 2d 511, 531 (S.D.N.Y. 2010)). Defendants' warning that "[f]ailure of new business concepts would have a negative effect on our results of operations …" is completely irrelevant as it refers to the P.S from Aeropostale store ***concept*** and not the new Meads fashion line. *See* Def. Ex. 14 at 13; Def. Ex. 7 at 12. Accordingly, while Defendants point to their standard risk disclosures relating to Aeropostale's business generally, these disclosures lack material and concrete information to put them in context and make them meaningful.

Additionally, and critical to the case at hand, the alleged cautionary language can not be considered meaningful because, at the time the disclosures were made, Defendants knew that many of the supposed risks were not merely hypothetical, but had already come to pass, and were continuing to occur. (*See* Section III generally). "Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired." *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004); *EVCI*, 469 F. Supp. 2d at 102. As this Court has stated: "'To warn that the untoward may occur when the event is contingent is prudent; ***to caution that it is only possible for the unfavorable events to happen when they have already happened is deceit***.'" *Id.* at 103 (emphasis added) (quoting *In re Prudential Sec. Inc. Ltd. P'ships Litig.*, 930 F. Supp. 68, 72 (S.D.N.Y. 1996)). That is precisely what transpired here. *See* Statement of Relevant Facts, §C, E.

Defendants point to one particular risk factor cautioning that any "unanticipated decrease in demand" for the Company's products could require it to "sell excess inventory at a substantial markdown, which could reduce [its] net sales and gross margins and negatively impact [its] probability." Def. Br. at 12. Not only is this common sense for the industry, but it is misleading and lacking in any substantive meaning without the accompanying disclosure of known, material facts regarding what was actually occurring at the Company's stores. Simply disclosing the *potential* effect of an unanticipated decrease in demand is wholly insufficient when that decrease in demand had already occurred and was sure to continue. *See Sgalambo v. McKenzie*, 739 F. Supp. 2d 453, 472 n.94 (S.D.N.Y. 2010) (quoting *Nortel,* 238 F. Supp. 2d at 629).

The same cautionary statements that accompanied the Company's first quarter projections also accompanied its 2Q11 guidance, and are similarly insufficient to invoke the safe harbor. In particular, at the time Aeropostale issued its 2Q11 guidance of $0.11 to $0.16 per share – which was overstated dramatically – Defendants knew that the spring and summer 2011 lines were selling extremely poorly even at reduced prices, and would end up sitting in storage rooms at the malls. (*See* ¶87). Accordingly, Defendants' purported "cautionary" statements, including that any "unanticipated" decreases in demand could negatively affect Aeropostale's net sales and gross margins, were not meaningful since those purported risks had already occurred. *See*, *e.g.*, *Sgalambo*, 739 F. Supp. 2d at 472; *Lin v. Interactive Brokers Group, Inc.*, 574 F. Supp. 2d 408, 417 (S.D.N.Y 2008).[10]

Finally, the safe harbor does not apply to material omissions. *See In re Complete Mgmt. Inc. Sec. Litig.*, 153 F. Supp. 2d 314, 340 (S.D.N.Y. 2001); *Oxford*, 187 F.R.D. at 141. Despite speaking about inventory and design issues numerous times in their public statements, Defendants failed to inform the market that the failed Meads' designs were ordered through summer of 2011, that this overhang problem would not be rectified in one or even two quarters, and that this would have a substantial impact on the Company's margins and profitability. *EVCI*, 469 F. Supp. 2d at 101 ("a duty to disclose information arises whenever it is necessary to disclose a fact to prevent another statement from being misleading"). For example, during the March 10, 2011 Conference Call, an analyst asked a ***direct question*** about the condition of the inventory, inquiring: "[i]t sounds like your inventories are in good shape now; where should we expect inventories at the end of Q1?" ¶92. Instead of correcting the analyst's belief that inventories were in good shape (which Defendants admit they were not at Def. Br. at 5-6), and informing the analyst that the poorly selling designs were ordered through summer 2011, Miller gave an evasive answer. *In re Sanofi-Aventis Sec. Litig.*, 774 F. Supp. 2d 549, 568-69 (S.D.N.Y.

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[10] It is for these reasons that the cases Defendants cite are inapplicable. *See Cement Masons* 2012 WL 685344 at *6; *Fort Worth Emp's Ret. Fund v. Biovail Corp.*, 615 F. Supp. 2d 218, 229 (S.D.N.Y. 2009); *In re Sierra Wireless, Inc. Sec. Litig.*, 482 F. Supp. 2d 365, 381 (S.D.N.Y. 2007). In these cases, not only did the cautionary language that accompanied the forward-looking statements expressly identify the specific risks alleged, but there was no showing that defendants knew that any of the purported risks had already come to pass or were occurring at the time the statements were made.

2011) (Defendants could have chosen to ***not*** respond to direct question from analyst but having chosen to respond, answer must not only be truthful but also complete).

2. Defendants Knew Their Forward-Looking Statements Were False and Misleading When Made

The PSLRA does not "protect [ ] a defendant from liability if a statement was knowingly false when made." *In re Alliance Pharm. Corp. Sec. Litig*., 279 F. Supp. 2d 171, 192 (S.D.N.Y. 2003). As shown above, Defendants had no reasonable basis for making the projections they did, and therefore are not entitled to safe harbor protection.

C. Defendants' Truth-on-the-Market Argument Fails

The truth-on-the-market defense provides that "a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market." *Ganino v. Citizens Utils. Co*., 228 F.3d 154, 167 (2d Cir. 2000). A defendant must prove that "the truth of the matter was already known" and was "conveyed to the public with a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by the alleged misstatements." *Id*. The truth-on-the-market defense is intensely fact-specific and is rarely an appropriate basis for dismissing a §10(b) complaint. *Id*.

Defendants point to Miller's statements during the conference call with analysts on March 10, 2011 as an example of Defendants informing the market of the extent of the inventory problems facing the Company. Def. Br. at 5-6. The full quote that Defendants refer to is as follows: "We have been aggressively marking down [inventory] through February and early March, … we are currently sitting at a 4% increase in retail per square foot, ***and its even lower than that on an absolute basis."*** Defendants omit the second part of the quote. The full statement sends mixed messages, at best.

Defendants also cite to a couple of analyst reports in an effort to show that the market was ***not misled*** by the Company's statements. Def. Br. at 6, 8.[11] Plaintiff, however, cites to numerous other analyst reports to show that the market was ***in fact misled***. *See i.e.*, ¶92 ("it sounds like your inventories are in good shape now"); ¶94 ("inventory has largely been sold through" and "issue is behind the company"); ¶95 (inventory carry-over … appears to be worked through"); ¶110 ("we believe aggressive markdowns will result in clean BTS [back-to-school] inventories."). Thus, there is at least an issue of fact as to whether the disclosures Defendants point to were conveyed with sufficient intensity and credibility to counter the false impression created by Defendants' misrepresentations. *See In re MBIA, Inc., Sec. Litig.*, 700 F. Supp. 2d 566, 583-84 (S.D.N.Y. 2010) ("Faced with these conflicting [analyst] reports, the Court cannot decide the fact intensive issue of truth-on-the-market on a motion to dismiss.").

Defendants also argue that investors should have known about the discounts being offered because those discounts were evident to customers. Def. Br. at 3, 6. Defendants do not explain why investors are not entitled to rely on Defendants' public statements misrepresenting the inventory issues and promotions. At best, this creates an issue of fact which should not be resolved at the motion to dismiss stage.

IV. THE COMPLAINT SUFFICIENTLY ALLEGES A SECTION 20(a) VIOLATION

Because Plaintiff has sufficiently pled a primary violation, that the Individual Defendants controlled Aeropostale (¶¶165-71, 182-8) and acted knowingly (or at least recklessly), Plaintiff's control person claim is actionable. *See Camofi,* 2011 WL 1197659 at *11.

CONCLUSION

For the foregoing reasons, Defendants' motion to dismiss should be denied in its entirety.

[11] Significantly, neither of the analysts cited by Defendants discuss spring and summer 2011 lines conceived of and pre-ordered by Meads in the failed new designs and the impact it would have moving forward.

Dated: New York, New York
March 26, 2012

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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

THE CITY OF PROVIDENCE, Individually and on Behalf of All Others Similarly Situated, Plaintiff, vs. AEROPOSTALE, INC., THOMAS P. JOHNSON and MARC D. MILLER, Defendants.	No. 11-CV-7132 (CM)(THK) CLASS ACTION

CERTIFICATE OF SERVICE

I hereby certify that on March 26, 2012, I caused the foregoing Plaintiff's Opposition to Defendants' Motion to Dismiss to be served electronically on all parties listed on the attached Electronic Mail Notice List.

/s/ Jonathan Gardner
Jonathan Gardner

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